

Privatization Assessment Workbook

**Utah Privatization Policy Board
2001**

What is Privatization?

There are several ways to define privatization. In our judgment, privatization means the provision of public sector services through the private sector.

There are two key points to understanding privatization. First, the definition of privatization is limited to those services traditionally performed by government that are being turned over to the private sector; it does not include services the government does not now provide. Second, privatizing delivery of a service does not necessarily stop the need to provide a service, it does not always give up its responsibility to ensure that the service is provided. However, there are two forms of privatization, service shedding and sale of assets, in which the government decides to discontinue a service.

Forms of Privatization

Privatization takes many forms. The most common form of privatization is contracting with the private sector. This is because contracting allows the government to maintain more control over the delivery of the service than the other forms of privatization. Some forms of privatization are:

- **Contracts** – Government contracts with the private sector to provide a public service.
- **Service Shedding** – Government turns over every aspect of a public service to the private sector, including whether the service will continue at all.
- **Sale of Assets** – Government sells its assets, such as property, to the private sector.
- **Franchises** – Government grants authority to a private sector firm to provide a service.
- **Vouchers** – Government issues coupons or tickets for clients to purchase goods or services from the private sector.
- **Leases** – Government pays the private sector for the use of equipment or facilities.
- **Subsidies/ Grants** – Government pays private firms to help cover the costs of providing services.
- **Partnerships** – Government and the private sector form a working relationship to provide a public service.
- **Deregulation** – Government removes its regulations from a service. It then encourages private or no regulation of the service.

Privatization experts identify other forms of privatization, such as using volunteers to provide public services, or coordinating the delivery of services relying on the private sector for assistance in providing a public service, or private firms loaning personnel or

resources to government. Finally, some experts consider private donations a form of privatization.

Privatization is Desirable When....

Privatization is when government contracts with the private sector to perform either a support function or a core government function. There are several needs that an agency might have that would prompt consideration of privatization. Potential reasons to outsource would be:

- Improve business focus
- Reduce cost
- Free-Up capital f
- Share risks
- Replace outdated systems
- Use current technology
- Reduce administrative costs
- Improve services
- Eliminate inventory

Once the needs of an agency have been assessed, the next decision is whether or not to privatize the service in question. Although it should not be a solution to all problems of government, Privatization is desirable when:

- It is likely to reduce cost to taxpayers.
- Services are readily available from several competing private for profit companies or other organizations.
- It is likely to improve the efficiency or quality of the service being provided.
- Sufficient controls are in place to protect the public from incompetence misuse of funds, and to ensure the integrity of the contracting and procurement process to provide for fair competition in securing government contracts.
- It eliminates or reduces unfair competition with the private sector.

Privatization is Undesirable When....

Privatization is perceived as having many advantages and disadvantages. Proponents and critics disagree on how to view privatization. Experts agree, however, that privatization is not always a solution for all problems and is not always appropriate for some government services. In addition, experts suggested privatization should be reviewed on a case-by-case basis because each situation is unique. Privatization can be undesirable when:

- It is likely to diminish the quality of service being provided.
- It will increase costs to the taxpayers (taking into account overhead, taxes, and other costs that may not be easily comparable).
- It hampers the ability of state agencies to perform their statutory missions.
- There is a lack of other alternatives in providing the service and it would result in reliance on a single source.
- Sufficient controls cannot be established to ensure protection of the public interest, the use of funds, etc.

Characteristics of Successful and Failed Privatization

Judging the success or failure of a privatized service is difficult. One person may view a privatized service as successful because it saved money. Another person may define it as unsuccessful because it resulted in a loss of control over the service. Although opinions differ, studies show that certain factors contribute to success or failure of privatization. These factors include:

- The existence of multiple private providers improves the chances of successful privatization. Competition among providers encourages efficiency and effectiveness.
- A thorough contract monitoring system improves the chances for success.
- The chances for success improve if the agency can specify exactly what it wants from the private sector and anticipate problems. Agencies that can easily measure what they want from the contractor are more likely to succeed with privatization.
- Agencies must accurately estimate the full costs of providing a service. Hidden costs for the agency or provider may result in unrealistic contract bids and contract failure.
- Agency executives must be open to the idea of privatization
- The less complex the service being privatized, the more likely are its chances for success.

Although the decision to privatize can be complex, a systematic and well-documented process can improve the chances for successful privatization.

Principles Of Privatization

Market Strength

When considering Market Strength, or the commercial characteristics of the service, question whether or not the service is readily available from several competing private companies or other organizations. Multiple vendors add to market strength by ensuring fair contract prices and competition. Competition not only challenges new players to participate, but it can improve the performance and efficiency of the service by the development of innovative approaches and technologies.

Privatization in a non-competitive environment can result in a monopoly where one supplier controls a commodity. A sole source provider may have no competitive pressure to improve the efficiency of its operation, maintain quality, or reduce costs.

Analyzing such characteristics as the duration of the contract and the magnitude of the financial commitment for a private firm can also illustrate market impact. When considering the duration of a contract, it has been found that short-term contracts are more desirable. If the contract, however, is short-term and the financial commitment is too large, it may not be easy for a private firm to provide the service. Initial investments can take many years to recoup and the state may not desire to have a lengthy commitment.

Political Resistance

Consider the question as to whether or not there will be a high resistance to change. This opposition to a privatized service can be heard from various groups such as the public, users of the service, interest groups, and public officials. Such political resistance can be low when a service delivered by government is poor or when the service is new. These qualities could create an open window for privatization. However, if the service has high political support and the public desires government to continue to provide the existing service, opposition will rise.

If Political Resistance arises, consider the time of implementation. Re-scheduling the event to a different date or time of year could help avoid conflict. Also, the ability to design compromises to the contracts or agreements can help resolve public fears and resistance.

If ideas of privatizing the service in question must be abandoned, consider the privatization of new and emerging services. Also, services that government is not satisfactorily providing may deliver little resistance to change. The public and political groups may welcome improvement to these services.

Those who are chosen to be involved in the decision process can be key to avoid strong Political Resistance. Early stakeholder involvement not only assists in building support for the decision, it can also be a key source of innovative ideas to enhance the project's success. Civic and business organizations, neighborhoods, advocacy groups, citizens, and consumers should be contacted and asked for their opinions and feedback. Legislative and political leaders should also be contacted to determine their viewpoints and priorities.

Cost Efficiency

Privatization can be a vehicle to reduce costs and increase competition and efficiency. The goal throughout a cost assessment should be that the quality and level of service remains the same. In order to acquire this initiative, assess whether or not the cost will increase or decrease. Also, determine where the savings lies. Of course, savings for the agency is a primary factor in the consideration of privatization, but an analysis of the impact on the consumers must also be measured. Added costs, such as additional fees paid to the private company can, in effect, reduce any savings the public might receive.

To help you obtain insight into whether or not there will be an annual decrease or increase in cost, please refer to Attachment A for the Detailed Cost Analysis Form. This analysis includes the costs for monitoring and negotiating the contract for both state and private providers, operating costs and taxes for the estimated time frame of the contract.

A strategy to help achieve cost savings and efficiency is to review bid or contract specifications and determine if changes would result in lower costs to provide the service. Another alternative is to build controls over cost into contracts through incentives for reducing costs such as Savings Sharing Contracts.

Quality of Service

The desire to improve the quality of a service, which is currently provided by the public, is often a significant reason for contracting that service to the private sector. At times, the private sector has a greater potential for innovation and efficiency due to its ability to be more flexible than government regarding personnel and resources, and is less burdened with bureaucracy and red tape. Contracting may offer the state the ability to respond to immediate needs with greater flexibility and speed than is possible under government operation.

To determine if private providers can deliver a service of better or equal quality, divisions/offices must gather data regarding the level of performance the state agency has achieved in meeting client outcomes and performance indicators. Divisions/offices

should emphasize outcome based performance standards for all private providers and develop performance-based contracts. The current focus on monitoring only process variables does not provide the state with information to adequately assess the quality of services provided by contractors or the state.

There is nothing uniquely inherent in the private sector that assures it will always do the job better or at the same level of quality. The state should consider if it is possible to improve or maintain the present quality of service. The obstacles to improving the public operation should be identified and the ability of the private sector to overcome these obstacles should be determined.

Impact On Employees

While privatization efforts may lead to workforce restructuring and downsizing, they also can translate into new opportunities for workers and communities. In order to mitigate the negative economic and social impacts on government employees, departments are equipped with several solutions such as job transfers, job placement and training, early retirement options, and extended health benefit coverage. Provisions in the contract can also be added to ensure the private firms hire the displaced employees.

The fewer the employees that are displaced the more favorable privatization becomes. If, however, the number of employees is high, workers whose jobs would be affected by privatization may be allowed to compete to retain the work “in-house” by improving performance and lowering costs.

Legal Barriers

An assessment of the role of Government, the agency’s legal authority, and possible legal barriers can also help one weigh the pros and cons of privatization.

One of the purposes of government is to secure the citizens’ basic rights to life and liberty. There are roles in which government must provide a service, such as access or treatment, consistently and equally throughout a large region or state. Also, factors such as federal mandates and standards dictate the level in which government must perform. Therefore, consideration of a private company’s ability to perform a role once carried out by government must be done.

Once this and the affirmation that the agency has the legal authority to privatize, legal barriers must be overcome. Such barriers might include the effect that existing laws

might have on your decision, whether laws would need to change, and whether the service in question has interrelations with other programs prescribed by law. If any of these barriers apply, it might be beneficial to speak to a legislative member to measure the level of support you would receive if a change in law needed to occur. Also, if a global privatization of a service is not possible, aspects, which can be separated and privatized, might appease the need.

Risks

Is there a chance that the private firm may fail to provide the service that government once guaranteed or reduce or stop services if financial losses occur? Privatization can increase government's exposure to hazards. To decrease such risks careful bid and contract development and project implementation must occur.

To reduce the risk of service interruption, provisions such as reporting requirements can be written within the contract along with the requirement of a performance bond. Also, another key to help reduce government risk is to maintain ownership of any equipment. This could allow government to maintain control over the cost of equipment and perhaps facilities used as well. The rate at which privatization is implemented can help reduce costs. For example, a slow phase into privatization, until government feels assured that the private company is capable and reliable, can reduce the exposure and magnitude of a failed project. Also, if cost adjustments for inflation and increased service requirements are built into the contract this could help prevent stopped services because of the company's financial losses.

Conclusion

In conclusion, the Utah Privatization Policy Board hopes that this booklet will be of aid to you as you carefully weigh all aspects of privatization. For any additional information regarding the Utah Privatization Policy Board, please refer to www.purchasing.utah.gov/ppb/ppb.htm

Acknowledgement

We gratefully acknowledge the Colorado State Auditor's Office who shared their Privatization Assessment Workbook with us, and allowed us to liberally copy and use their information in Utah's workbook.

Attachment A

Detailed Cost Analysis Form

These forms contain various cost factors used in determining an annual dollar cost for providing a service. The process results in an annual estimate of the expected decrease or increase in cost. The list of cost factors covers a broad range of issues that should be considered. These issues, however, may not relate to all privatization candidates and determining a dollar value for some issues may be difficult. Agency management should try to identify the characteristics that cause government to have higher or lower costs.

Instructions: There are three steps in the detailed cost analysis

- ☐ **Step 1** - Calculate the total government provision cost using PART of this form.

Total Government Provision Cost =

- ☐ **Step 2** - Calculate the total contracting cost using PART 2 of this form.

Total Contracting Cost = _____

- ☐ **Step 3** - Calculate the difference between the costs of STEP and STEP 2

Difference Between STEP 1 and STEP 2 =

Attachment A

DETAILED COST ANALYSIS

PART 1

GOVERNMENT PROVISION COSTS

Purpose: Costs Of Government Performing The Service For The Current Or Projected Level Of Service.

This part contains a series of cost factors. Some privatization candidates may have cost factors that are not listed here. These additional factors can be added at the bottom.

Consider each applicable cost factor and place the estimated cost, in dollars,, in the space provided. Add all amounts for cost factors and place the total at the bottom of this form. Transfer this amount to the front page in the allotted space for **STEP 1**.

Cost Factors

Amount

Salaries Of Department Personnel (Including: Taxes, PERA,
Unemployment Insurance, And Other Fringe Benefits)

Service And Supplies: Operating Costs (Fuel & Maintenance)

Equipment (Capital Outlay)

Equipment (Interest Cost)

Operation And Maintenance Of Buildings

Cost Of Premiums Paid For Liability And Fire Insurance Or
Claims Paid In A Self Insurance Program

Allocated Administrative Costs

Allocated Overhead Cost Of Other Executive And Staff Agencies

Management, Supervision, Oversight
(Similar To Contract Oversight)

Other Cost Factors

Total Government Provision Cost =

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Attachment A

DETAILED COST ANALYSIS

PART 2

CONTRACTING COSTS

This form contains a series of cost factors. These factors are grouped into four broad categories:

Start-Up Costs

Primary Costs

Contract Oversight Costs

Contractor Support Costs

Some privatization candidates may have cost factors not listed here. Please add these where appropriate.

The first step is to consider each applicable cost factor and place an estimated cost, in dollars, in the space provided. Determine a total for each category and place at the bottom of this form. Then add all categories to determine total contracting costs. Transfer this amount to the space provided on the front page under STEP 2.

START-UP COSTS

To spread out (amortize) the start-up costs over time, divide each estimated cost by the number of years you desire and place this amount in the space provided.

COST FACTORS

AMOUNT

Request For Proposal – Development & Implementation

Contract Development

Bid Preparation

Bid Selection

Contract Monitoring System Development

Unemployment Benefits Liability For Displaced Workers

Leave Benefits Buy-Out, Severance Pay, And Accrued Liabilities
For Displaced Workers

Attachment A

COST FACTORS

AMOUNT

Disposing Of Unused Equipment Write-Off Depreciation,
Under-Utilization Of Space.

Note: There May Be Benefits Or Gains, If Sold, If So, Subtract
Rather Than Add This Amount

Transition Costs Such As Duplication Of Effort

Other Cost Factors

Total Start-Up Costs =

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PRIMARY CONTRACTING COSTS

COST FACTORS

AMOUNT

Contract Price (Annual)

Allowance For Cost Over-Runs (Annual)

Affect On State Revenues (Will The State Stop Collecting
Users Fees?)

Estimated Cost Of The State Losing Any Grants Or Subsidies

Other Cost Factors

Total Primary Contracting Cost =

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Attachment A

CONTRACT OVERSIGHT COSTS

COST FACTORS

AMOUNT

Salaries

Fringe Benefits

Service And Supplies

Equipment (Capital Outlay)

Equipment (Interest Cost)

General Operating Costs

Operation And Maintenance Of Building

Other Cost Factors

Total Contract Oversight Cost =

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CONTRACT SUPPORT COSTS

COST FACTORS

AMOUNT

Space Provided

Equipment Provided

Other Cost Factors

Total Contractor Support Costs =

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Attachment A

SUMMARY OF CONTRACTING COSTS

Place the totals for each category in the following spaces. Then add the amounts to obtain the total contract costs.

Contracting Cost Factors	Total Costs
Total Start-Up Cost	
Total Primary Cost	
Total Contract Oversight Cost	
Total Contractor Support	
Other Cost Factors	
TOTAL CONTRACTING COSTS	